JPMorgan Investor Services

thought

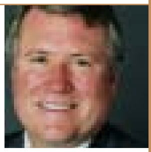
IDEAS FOR
A CHANGING
GLOBAL ECONOMY
Q4/2003

Dr. Alberto Giovannini,
CEO, Unifortune
Asset Management

European Clearance and Settlement: An Interview with Dr. Alberto Giovannini

JPMorgan

thinking out loud



Tom Swayne, JPMorgan Investor Services Executive

We are pleased to present you with the year end issue of *Thought* magazine. While the economic environment remained a challenge for the global markets, 2003 was a better year. We saw much less volatility in recent months with the U.S. economy in particular beginning to exhibit signs of a sustainable recovery.

This issue of *Thought* includes stories highlighting many interesting and timely topics. Our cover story, "European Clearance and Settlement: An Interview with Alberto Giovannini," features a discussion with one of the world's foremost experts on the European financial markets, Dr. Alberto Giovannini, the author of the *Giovannini Report*. This important report is working to address no less than 15 barriers to an efficiently integrated European securities market, and will have a major impact on the reform of trading processes across Europe.

Continuing to seize the opportunities created by the downturn of the past few years, JPMorgan has created a number of highly innovative products and services for our clients. For example, page 20, "A Collaboration Produces Solutions Rooted in Client Needs," features Investor Services' partnership with our Investment Bank colleagues to create an inventive Mortgage Optimization solution for one of our important Insurance clients. It highlights one of our most important goals as a firm, to leverage the strengths and expertise of our entire organization, working to develop creative solutions that seek to enhance our clients' day-to-day experience.

"JPMorgan Message Express℠: Optimizing Messaging Efficiency for Today's Financial Markets," on page 24, showcases our new Message Express product, a robust message management service that provides financial institutions links to industry messaging utilities without the technology costs associated with the multiple and changing requirements of industry and counter-party standards.

Going the extra mile and developing a reputation for creating useful products and services based on our clients' needs are among our greatest strengths and what we believe distinguishes JPMorgan from our competitors. No matter what the environment, we will continue to work to provide you, our clients, with the most dynamic and value added products and services available in the marketplace today.

From everyone here at JPMorgan Investor Services, we wish you and your family a safe and happy holiday season, and a prosperous New Year.

Tom Swayne
Investor Services Business Executive

thoughtcontent

COVER STORY

FEATURES

IN EVERY ISSUE

viewpoint

european clearance and settlement: an interview with alberto giovannini

Dr. Alberto Giovannini currently serves as chief executive officer and director of Unifortune SGR SpA, an asset management company based in Milan, Italy, and chief executive officer of Unifortune Investment Management Ltd., an investment company in London. He is also chairman of the Consultative Group on the Impact of the Euro on European Capital Markets at the European Union in Brussels, also known as the Giovannini Group. Dr. Giovannini's vast industry experience includes Deputy General Manager of Banca di Roma, a member of the board of Borsa Italiana SpA (the Italian Stock Exchange) and the Montetitoli SpA (the Italian central security depository). In addition he was the Jerome A. Chazen Professor of International Business at Columbia University, during which time he was also a Research Associate of the National Bureau of Economic Research in Cambridge, Massachusetts and a Research Fellow for the Centre for Economic Policy Research in London. He is currently Honorary Professor and Chairman of the Academic Committee of the Center for the New Economy, Zhongshan University in Guangzhou, China and Advisor of the Institute of Contemporary Finance, Jiao Tong University in Shanghai.

A committee has been described as a group of people who individually can do nothing, but collectively decide that nothing can be done. Now the truth of this tongue-in-cheek theory is being tested in Europe, where the Giovannini Group has identified the major barriers to efficiency in the securities clearing and settlement infrastructure and has recommended an ambitious plan of action to remove them.

The Giovannini Group, headed by Italian academic and financier Dr. Alberto Giovannini, advises the European Commission on financial market issues. The Group has previously produced reports on the re-denomination of bond markets into the euro, the European repo market and coordinated issuance of euro-area government bonds. In 2001, it published its initial findings on cross-border clearing and settlement arrangements within the European Union (EU), and followed this up in 2003 with an action plan to remove 15 barriers to efficiency.

Why is the European Commission so interested in securities clearing and settlement? According to Dr. Giovannini, it plays a key role in the success of the plan for a single European capital market. "The Financial Services Action Plan largely ignores clearing and settlement," he says. "They forgot to look at the foundations of the building. The European Commission now recognizes this and that is what our work is all about."

While Europe's inefficiencies have long been a source of irritation to investors, progress towards real improvement has been slow and fragmented. Consolidation of infrastructure providers, such as central securities depositories and central counterparties, has been seen as one of the key drivers of cost and risk reduction, yet 2003 has seen a net increase in the number of central counterparties, while no new depository mergers have taken place since Euroclear and the U.K.'s CRESTCo merged in 2002.

"Our proposals are **promoting competition,**

Obstacles to Progress

The Giovannini Group identified the drawbacks of total reliance on market forces to improve post-trade processing efficiency. "The rather limited and sporadic process of consolidation (among EU clearing and settlement providers) that has been witnessed so far reflects uncertainty about the future regulatory, fiscal and legal environment in which clearing and settlement will be provided in the EU," the second report said. "The existence of a clear and credible strategy for removing the 15 barriers is vitally important to remove this uncertainty. In these circumstances, the process of consolidation would be likely to accelerate."

Further obstacles to progress have arisen because of the different ways in which markets have structured their trading, clearing and settlement services. In some markets, such as the U.K., the trading platform is entirely separate from clearing and settlement, both of which are provided by third-party specialists. In others, including Germany and Italy, trading, clearing and settlement are all vertically integrated under a single ownership structure. Additionally, some clearing and settlement agencies are user-owned and user-governed, while others are publicly listed companies. These different ownership and governance structures have made pan-European cooperative ventures and industry initiatives more problematic, slowing the pace of change.

Trade associations such as the European Securities Forum, of which JPMorganChase is a member, have been working hard to influence operational upgrades within markets that would significantly improve processing efficiencies, but the critical role to be played by governments and regulators in mandating change is highlighted by Dr. Giovannini. "Some two-thirds of our recommendations rely on the involvement of the authorities," he says.

A Different Business Model

The 15 barriers identified by the Giovannini Group fall into three categories: national differences in technical requirements and market practice; national differences in tax procedures; and issues relating to legal certainty. They are:

1. National differences in information technology and interfaces
2. National clearing and settlement restrictions that require the use of multiple systems
3. Differences in national rules relating to corporate actions, beneficial ownership and custody
4. Absence of intra-day settlement finality
5. Practical impediments to remote access to national clearing and settlement systems
6. National differences in settlement periods
7. National differences in operating hours/settlement deadlines
8. National differences in securities issuance practice
9. National restrictions on the location of securities
10. National restrictions on the activity of primary dealers and market makers
11. Domestic withholding tax regulations serving to disadvantage foreign intermediaries
12. Transaction taxes collected through a functionality integrated into a local settlement system
13. The absence of an EU-wide framework for the treatment of interests in securities
14. National differences in the legal treatment of bilateral netting for financial transactions
15. Uneven application of national conflict of law rules

This is an awe-inspiring list of shortcomings and barriers to greater efficiency, yet the prize is worth pursuing. "Within the European Union, we are working towards a free market, democratically run and with soundness built into the system," says Dr. Giovannini. "To achieve this, we will have to adapt to a fundamentally different business model."

A Directive Too Far?

As drafted by the Giovannini Group, the new model relies heavily on the involvement and action of both the public and the private sector. For each of the 15 barriers that the Group identified in its initial report, it subsequently recommended a plan of action, with a timetable and suggested sponsors. As the report says: "The removal of the 15 barriers is the essential prerequisite for fully integrated and efficient EU clearing and settlement arrangements."

Political interest in the clearing and settlement debate has been intense. At the beginning of 2003, the European Parliament issued a detailed resolution calling for the European Commission to introduce a clearing and settlement directive, laying down a common framework — to include authorization, rules of operation, supervision and cooperation between competent supervisors, and passporting — for the exercise of clearing and settlement activities.

Sticking with the Plan

Even if a directive seems unlikely, Dr. Giovannini believes that all the relevant authorities must sign up to the plan. "The success of our project is entirely dependent on the public sector priorities that we have identified," he says. "But we must separate the political hype from the operational and commercial objectives of the plan. The challenge is to get all players to understand the importance of the fundamentals, so that the market can reap true economies and benefits from removing these barriers."

As Dr. Giovannini acknowledges, that is a challenge that may prove very tough. "We have to ask whether all clearing and settlement providers understand the plan," he says. "This is a very delicate point: how do these providers come up with a structure that minimizes costs and risks? The big players need to work out how to use their influence and size positively. We have given them the initiative to make the changes, but they must stick to the overall plan."

Some infrastructure providers may be concerned about the long-term effects of committing to the changes recommended by the Group. "Of course, some might stand to lose out once the barriers are removed and the playing field is leveled," says Dr. Giovannini. "But who knows what the outcomes will be? It is far too early to tell."

In terms of immediate priorities, the second report states that those barriers that restrict the location of settlement activities are at the top of the list. "If these are removed," the report says, "investors can choose where to locate their post-trading activities and set in train a market-led integration of clearing and settlement arrangements across the EU."

But some see this approach as running counter to the prevailing enthusiasm for utility consolidation, with the lifting of such restrictions giving investors more choice and therefore creating further competition. Dr. Giovannini appreciates the concern, but explains the rationale behind the recommendations. "Our proposals are promoting competition, but we expect consolidation to result," he says. "As the successful providers add scale, there will probably be a lot more consolidation." He also hints that, should the recommendations fail to achieve their goal, there is another way. "Some would call it the nuclear option," he jokes, "but the market might end up with the European version of the U.S.'s Depository Trust & Clearing Corporation. Don't forget that the European Commission has already done that with the European Central Bank. It may not be what the market wants, but it might be the only alternative."

Work in Progress

The Giovannini Group's proposals have far-reaching ramifications, most obviously in opening up the possibility of low-cost cross-border investment to both retail and institutional investors in Europe.

Ramy Bourgi, business executive for JPMorgan Investor Services Europe, Middle East and Africa, says that the firm is closely monitoring the progress in this area. "Our clients will greatly benefit from a streamlined and consolidated infrastructure, operating in a harmonized European securities market. We see the Giovannini Group's efforts as a positive move in the right direction and we are very supportive of its work."

"Our clients will **greatly benefit** from a streamlined and consolidated

Ed Neeck, Network Management and Product executive for JPMorgan Investor Services, says that the recommendations are closely aligned with the bank's objectives for infrastructure improvement. "As we see it, four key changes are needed to make a difference: the removal of national tax, legal and regulatory barriers; the creation of a single securities clearing and settlement utility; improvement of straight-through processing (STP) and linkages among market participants; and, harmonization of the timing of cash and securities settlement. We're pleased to see that the Giovannini recommendations are very much in line with our objectives."

But Neeck is cautious about the speed of progress. "Even though there is general agreement about what needs to be done to reform European clearing and settlement, there are still different views about implementation," he says. "The usual roadblocks inhibiting change remain: politics, vested interests, complexity and resources."

Despite these issues, Neeck points to the work done by Euroclear as a good example of what the market can achieve without regulatory intervention. "Euroclear has put a stake in the ground and has rolled out a plan to put in place a single settlement engine for six major European markets, accounting for almost 60% of total European securities clearing and settlement volumes," he says. "Euroclear's solution for creating this single settlement engine will be funded through existing operations and will not require special funding or legislative change."

Neeck also highlights the potential benefits accruing from usage of the SWIFT network. "Some of the Giovannini Group's recommendations focus on improving efficiency through interoperability, STP and electronic messaging among clearing and settlement entities," he says. "This is precisely where SWIFT and its users have a very large leadership role to play. With the introduction of ISO 15022 and, most recently, SWIFTNet, it is clear that further standardization in messaging will reap dramatic benefits in improving STP rates and lowering costs."

In Summary, the Giovannini Group's Recommendations are:

- Operating hours and settlement deadlines should be harmonized, using TARGET hours as the benchmark.
- National differences in the information technology and interfaces used by clearing and settlement providers should be eliminated via an EU-wide protocol.
- Intra-day settlement finality in all links between settlement systems within the EU should be guaranteed.
- Settlement periods for all equity markets within the EU should be harmonized.
- National rules relating to corporate actions processing should be harmonized.
- National differences in securities issuance practice, in particular in relation to allocation of International Securities Identification Numbers (ISINS), should be eliminated.
- All financial intermediaries established within the EU should be allowed to offer withholding agent services in all of the Member States so as to ensure a level playing field between local and foreign intermediaries.
- Any provisions requiring that taxes on securities transactions be collected via local systems should be removed to ensure a level playing field between domestic and foreign investors.
- An EU Securities Account Certainty project should be agreed upon by national governments.
- National restrictions on the location of clearing and settlement and on the location of securities should be removed as an essential pre-condition for a market-led integration of EU clearing and settlement arrangements.
- Practical impediments to remote access to national clearing and settlement systems should be removed in order to ensure a level playing field.
- Restrictions on the activity of primary dealers and market makers should be removed.

infrastructure, operating in a **harmonized** European securities market." RAMY BOURGI

Nothing Less Than a Revolution

The success of the Giovannini Group's work does not hinge solely on public and private sector buy-in. It also depends heavily on two related projects: the proposals for new regulatory standards that have recently been released by a joint working party of the European System of Central Banks and the Committee of European Securities Regulators (ESCB-CESR), and the ongoing inquiry by the European Commission into competitive aspects of clearing and settlement systems.

The ESCB-CESR proposals set out the regulatory standards that might be adopted for securities clearing and settlement systems in Europe, and are currently going through the consultative process with interested parties. Separately, the European Commission is working on competition issues, especially regarding discriminatory and excessive pricing and exclusive access arrangements.

Clearly, the combined effects of these three separate but closely related initiatives could dramatically reshape the clearing and settlement infrastructure. Dr. Giovannini suggests that what is at stake represents much more than incremental change. "We are talking about nothing less than a revolution," he says. "We have purposely not drawn the blueprint for the market, but one will be produced naturally as the action plan is implemented."

Bourgi confirms that Investor Services is committed to keeping clients well versed on the proposals and any actions that emanate from them, recognizing it may be confusing for institutional investors and certainly difficult for them to stay on top of the latest developments. "We are engaging our clients more and more on topics related to European industry initiatives and highlighting to them the impact these changes may have on their business. We have spoken to clients about the findings of the Giovannini Group's work and will keep them updated as the work progresses on all of the related initiatives."

Next Steps

JPMorgan Investor Services is a committed supporter of the Giovannini plan. "As a major global financial services firm, with a very significant European presence, we are very keen to ensure that the best interests of our clients are protected and that they benefit from processing improvements," says Ed Neeck.

Neeck explains that implementation of the recommendations would not simply affect operational services. "Asset managers, and their clients, would be likely to experience better market liquidity and lower all-in execution costs as a result of Giovannini," he says. "This is a major opportunity to reform cross-border trading and investment in Europe."

As yet, the next steps of the European Commission are unclear. But Dr. Giovannini maintains that the revolution has already started. "Most of the leading opinion-formers and decision-makers know that these changes are inevitable, precisely as was the case with the Economic and Monetary Union," he says. "There is no other game in town. The Commission is the only authority with a key role to play in improving clearing and settlement arrangements."

Perhaps the most immediate issue is how implementation will be overseen. The Giovannini Group recommended that there should be "a powerful monitoring and coordination mechanism, able to provide an efficient interface between private sector and public sector initiatives, to monitor the progress and the consistency of the overall project, reporting critical issues to the Economic and Financial Affairs Council (of the European Commission), and the overall progress to the public. This body should have the capacity to galvanize action and ensure parallel progress across both the public and private spheres. In addition, it would be responsible for explaining to policy makers — and to the public — the state of the reform, and advise on any significant developments in the project."

In the meantime, Dr. Giovannini waits with the rest of us to discover what will happen next. "I have a great commitment to this area and I am certainly ready to do more," he says. "But, as yet, I don't know what my involvement will be." Whatever happens next, his group has at least disproved the theory that all committees conclude that nothing can be done. ○○○

other initiatives

In addition to the Giovannini Report, there are a number of regulatory and legislative initiatives currently affecting the industry. The following is a list of some of those that are regularly covered in the industry press as well as a summary of their scope and purpose:

REGULATORY

Patriot Act

Looks to strengthen, amongst other perhaps more controversial elements, anti-money laundering (AML) laws via regulations that make it more difficult for criminals and terrorists to run money through the U.S. financial system and beyond U.S. borders. Provisions include strengthened due diligence requirements regarding client and correspondent relationships, creation of AML training and compliance programs, and stricter reporting requirements for suspicious activity in securities transactions as well as cash transactions.

Sarbanes-Oxley Act

Designed to avert corporate accounting scandals and conflicts of interests involving company executives. Applies to U.S. based corporations and financial institutions. Requires CEOs and CFOs to file reports attesting that financial reports are true, correct and conform to proper reporting and accounting standards. The Act also sets stricter rules regarding formulation of audit committees and auditor independence.

Basel II

In January 2001 the Basel Committee on Banking Supervision issued a proposal, The New Basel Capital Accord (currently planned to become effective in 2005 or 2006). The new Accord, which once finalized will replace the current 1988 Capital Accord, applies a uniform model to banks on a global basis. The Accord seeks to control operational risk, promote market resilience and ensure the effectiveness of Business Continuity Planning objectives by requiring banks to set aside a certain amount of capital, and is based on three pillars that allow banks and supervisors to evaluate properly the various risks that banks face. The Accord focuses on:

- Minimum capital requirements, which seek to refine the measurement framework set out in the 1988 Accord;
- Supervisory review of an institution's capital adequacy and internal assessment process; and
- Market discipline through effective disclosure to encourage safe and sound banking practices.

CLEARANCE AND SETTLEMENT

CPSS-IOSCO

The Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO), created a Task Force on Securities Systems in December 1999, comprised of 28 Central Bankers and securities regulators from 18 countries and regions as well as the European Union (EU). First published in January 2001, the "consultative" report on the design, operation and oversight of securities settlement systems identifies and explains 18 recommendations that are the minimum requirements that such systems should meet, and the best practices they should strive for. The recommendations are designed to cover systems for any type of security in any type of market, and consider both domestic and cross-border trading.

ESCB-CESR

The European System of Central Banks (ECSB) and the Committee of European Securities Regulators (CESR) have published two documents entitled *Standards for Securities Clearing and Settlement Systems in the European Union* and *The Scope of Applications of the ECSB-CESR standards*. These documents are intended for public consultation related to the joint work being done by the ESCB and CESR in the area of securities clearing and settlement. The first document contains 19 standards, which aim to increase the safety soundness, and efficiency of securities clearing and settlement systems in the EU. The standards are based on the CPSS IOSCO recommendations for securities settlement systems of November 2001. The second document explores the possibility of applying certain standards to major custodian banks that provide securities clearing and settlement services. The ESCB-CESR working group is composed of representatives of the ECB, the 15 national central banks of the EU and representatives of CESR.

Group of Thirty (G30)

The G30 has issued a series of important recommendations designed to substantially impact the future of the global securities market. Prompted by the general market compliance with the original 1989 G30 recommendations and dramatic growth in cross border development over the past decade, the 2002 G30 report sets an ambitious new agenda. It entails a comprehensive reform of the clearing and settlement process by advocating uniformity across markets, requiring a significant level of global cooperation to implement. The report seeks to address the lack of growth in the underlying framework on which these global trading systems rely focusing on three key areas of interest including:

- Creating a strengthened, interoperable global network;
- Mitigating risk; and
- Improving corporate governance.

Giovannini Report

This report reviews issues and concerns regarding cross border clearance and settlement within the EU, and addresses 15 significant barriers to clearance and settlement efficiency, issues related to tax, regulatory and legal matters and considers actions to eliminate the barriers and where the responsibility to remedy them lies. The report calls for intensive cooperation between public and private sectors and highlights that without an integrated clearance and settlement system, a single EU securities market will never exist. To promote a sense of urgency, the deadline for implementation is an ambitious 2 to 3 years. The report also deals with important public policy issues that are important for cost effectiveness and ensuring the desired level of systemic stability, and stresses that market participants should play the greatest role possible. Progress can only be achieved with the strong commitment of both national governments and the EU Commission.

L E G A L

SEC Rule Amendments Regarding Proxy Voting Policies, Disclosure by Investment Companies and Investment Advisers

The Securities and Exchange Commission adopted rule amendments in January 2003 that require mutual funds and other registered management investment companies to both disclose their proxy voting policies and procedures and their actual proxy votes cast. These amendments are designed to enable fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies and to encourage funds to vote their proxies in the best interest of fund shareholders. The amendments require a fund to file new Form N-PX, containing a complete proxy voting record for the 12-month period ended June 30 by no later than August 31 of each year. Funds will be required to disclose the following information for each matter on which a Fund was entitled to vote: identifying the matter voted on; if the matter was proposed by the issuer or a security holder; whether and how the fund cast its vote; and if the fund cast its vote for or against management. Funds will be required to make their first proxy voting disclosures not later than August 31, 2004, for the 12 months ending June 30, 2004.

Hague Convention

The basic purpose of this project is to provide financial markets with legal certainty for dealings in indirectly held securities. Agreement on a convention that produces a uniform and rational rule for determining the proprietary aspects of a transfer or pledge of indirectly held securities is essential to market users, market participants and the financial system as a whole. The conflict of laws rule for determining the proprietary aspects of a transfer or pledge of securities is traditionally based on the *lex rei sitae* principle, which applies the jurisdiction applicable to the place the securities are held. Today, the vast majority of actively traded securities are held through a system of intermediaries, effectively creating a complicated series of 'look through' to determine the location of the issuer of securities, the issuer's register, or the location of the actual securities certificates — all three of which could be in different legal jurisdictions.

An alternative approach is to look to the law of the location of the intermediary maintaining the account to which the securities are credited (the "place of the relevant intermediary approach" or "PRIMA"). The major advantage of PRIMA is that the question of whether the collateral taker receives a perfected interest will be governed by the law of one jurisdiction even where a portfolio of securities of issuers from different countries is involved. PRIMA has already been adopted by several jurisdictions. *The future Hague Convention will embody the PRIMA principle at the international level, thus greatly enhancing legal certainty and predictability, and thereby allowing for easier access to international capital.* ○○○

jpmorgan's industry initiatives:

transforming global reach into a competitive edge

In a rapidly evolving and increasingly global business such as securities lending, taking on industry-wide initiatives and leadership positions can make the difference between firms that are securities lenders and those that are lending leaders.

Here's why. There's no question that the global securities lending industry as a whole is expanding and evolving at break-neck speed, with an estimated $2 trillion of securities on loan at any time. Also, according to a leading industry organization, in March of this year there were securities on loan valued at approximately €750 billion, with €4.4 trillion worth of securities available to lend. Over the past two decades, the industry has grown to deal in securities from more than 25 countries around the world, and continues to both widen and deepen due to increased demand for both U.S. and international securities. More sophisticated trading strategies and the growth and deregulation of international markets have created new trading opportunities. Perhaps most important, as markets endure cyclical turns and as once-favored asset classes suffer prolonged downturns, the need for many asset managers to supplement returns has transformed securities lending from a somewhat elusive practice to a regular, more widely accepted method of adding alpha.

With such growth, however, come regulatory developments, tax issues and all the normal growing pains characteristic of an industry in flux. And while all of this may be exciting and rife with new opportunities, the dynamic environment presents a unique and formidable responsibility to a lending agent, according to Gene Picone, senior vice president and global head of Securities Lending, JPMorgan Investor Services. "In order to properly keep abreast of industry changes and the pulse of the industry, in-depth, active involvement in industry organizations and initiatives is essential in maintaining a competitive edge and protecting the interests of our clients," he asserts. What's more, the firm possesses the unique ability to actively leverage its global reach in order to help shape the industry. Simply put, "This type of work is essential in remaining a market leader," he says.

Driven by Responsibility to Clients

JPMorgan is currently active in several industry organizations and initiatives, with a more concentrated focus on three select groups: the International Securities Lenders Association (ISLA), the Risk Management Association (RMA) and the Investment Company Institute (ICI). Of these, the firm's primary focus is with the RMA, although the general purpose and goal of JPMorgan's involvement remains consistent among all three groups.

"We view our industry involvement as essentially twofold," says Picone. "First, we extend our time and resources to become involved in the industry on a leadership level as a way of ensuring we can provide the highest level of client service possible. Without staying informed ourselves, we couldn't possibly offer our clients vital information on the industry, regulatory issues, current and impending legislation, and so on. So, in this sense, it is clearly a way to better serve our clients. Second, our size and scope carries with it substantial influence, whether it is with regulatory authorities or industry groups themselves. Because of this, we have the ability — and therefore, a responsibility — to act as an advocate for our clients and work to shape the industry with our clients' best interests in mind."

Picone is careful to stress that JPMorgan's industry-wide efforts are not to be confused with lobbying. "We work on committees within each organization, often as group leaders, to examine current industry issues, laws, and defining best practices, as a rule. Our efforts are strictly focused on helping regulators understand the nature of our business and the challenges we face, as well as clarifying what we believe would be in clients' best interests."

In order to properly keep abreast of industry changes and the pulse of the industry, **in-depth, active involvement in industry organizations and initiatives is essential** in maintaining a competitive edge and protecting the interests of our clients

Another point Picone highlights is that interaction within industry groups and committees is decidedly noncompetitive. "The great thing about committee involvement is that you get to hear what other firms are doing," he says. The RMA, for example, prohibits participating firms to discuss pricing, proprietary program features and other such competitive issues at meetings.

Each Group Unique, With Common Purpose

While each industry organization pursues unique objectives, there are a few common threads among most of them. In general, most securities lending industry organizations aim to work toward the creation of an orderly securities lending market globally, and to helping earmark general industry standards and practices. For example, ISLA's official aims are to represent the common interests of securities lenders, to provide its members with a forum, and to assist in the orderly, efficient and competitive development of the securities lending market. ISLA was established in 1989 and currently represents over 50 members in the European and international securities lending markets. As its name implies, the organization is comprised of a diverse membership and tends to address broad, global issues.

The RMA, on the other hand, takes up another charge that is common to many industry organizations in that it primarily acts as a liaison between the financial services industry and bank regulatory agencies. Picone explains that this often entails helping define and set industry policies, but also, educating regulators. "It's all about helping everyone involved make more enlightened choices," he says. Also, as a nonprofit professional association, RMA does not lobby on behalf of the financial services industry. However, it does have frequent interaction with industry regulators to discuss issues of mutual concern to industry participants.

Picone, who sits on the RMA's executive committee, says JPMorgan's current emphasis with the RMA is largely an issue-driven decision. "So many hot issues right now in the securities lending arena happen to fall under the RMA's jurisdiction," he admits. For example, JPMorgan played an integral role in a recent industry debate involving an inquiry by the SEC and the NYSE to determine how much detailed information the broker dealer community should garner and hold about their customers. "The broker dealer community wanted to comply, but explained to the regulators that the lending agent really possesses most of the customer-specific information," says Picone. "We were asked to step in and speak to the

SEC and essentially walked them through how our business works. We needed to demonstrate how we operate, what type of information we believed would be appropriate for the brokers to hold, and basically helped raise awareness and assure them that we are watching out for our borrowers as well. Essentially, we were the voice of reason in that event."

The RMA's size, scope and domestic focus are other reasons for JPMorgan's interest. The RMA's Committee on Securities Lending, which was established in 1983, currently has more than 650 members comprised of banks, brokerage houses, pension funds, endowments and other institutional lenders. The Association's biannual survey is an aggregate composite that measures various performance indicators within the securities lending marketplace. Approximately 25 banks participate in the RMA survey. Clearly, the RMA holds a tremendous influence in the marketplace and offers member firms an extraordinary opportunity to gain an edge. "A lot of what we work toward at the RMA is opening up new markets to add liquidity and make securities lending a smoother, more efficient process overall," says Picone. "All of our clients stand to benefit from our united efforts in this regard."

Working actively with industry groups allows us to **stay ahead of our competition** and add true value to our client relationships.

Working with ICI and ISLA

JPMorgan's presence in the ICI gained momentum recently, given the organization's allegiance to the mutual fund industry, a large and valued segment of the securities lending industry's client base. "The ICI Tax Committee, in particular, has been extremely active sorting out the latest tax legislation and the effects on the industry," says Frank Seyboth, vice president and director of Tax and Financial Reporting for JPMorgan Investor Services. "The Jobs and Growth Tax Relief and Reconciliation Act of 2003 ("The Act"), enacted on May 28, 2003, has made investing in dividend generating stocks more attractive to individual investors but has created additional challenges for lenders of securities. With our involvement in the ICI, we better understand the operational issues facing mutual funds that lend securities and are able to communicate these issues to our client base."

Seyboth continues, "In fact, we have conducted a continuous series of one-on-one meetings with JPMorgan's Securities Lending program clients to discuss the Act and its effects in greater detail. Our partnership with ICI definitely contributed to the success of our individual client meetings." Investor Services spearheaded the effort, consisting of experts from JPMorgan's Tax, Legal, Securities Lending and Investment teams who met with clients personally to go over the new tax law's potential impact on a specified portfolio.

PASLA, or the Pan-Asian Securities Lending Association, is a "sister" organization to ISLA, and currently has 33 member firms, 16 of which are represented by PASLA's Hong Kong office. Seventeen other members of the group are domiciled across six other countries — Singapore, Japan, Korea, Australia, the United Kingdom and the United States. PASLA membership is open to both *international* firms, which are active in several markets, and *local* firms, which are primarily active in their home market. In the past, PASLA has conducted seminars and roundtables with regulatory authorities and market participants in the local markets. This has proven to be a successful formula by providing an open forum for discussion and exchange of information. JPMorgan currently has a corporate officer domiciled in Japan who keeps abreast of PASLA developments for the firm.

Leading to Direct Benefits for Clients

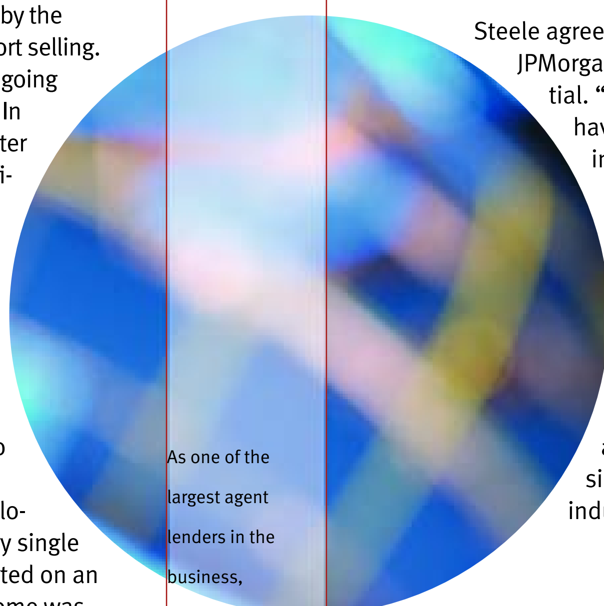
JPMorgan generally has at least one senior level professional engaged in each organization at any time, often in a leadership role. JPMorgan's Richard Steele, vice president and head of Product Development, JPMorgan Investor Services Securities Lending & Investment Products, recently elected deputy chairman of ISLA, explains the depth of ISLA's scope and influence. "While ISLA technically has 50 members, it actually represents many more market participants beneath that number, since like JPMorgan, many of those members are agents who have quite a few beneficial owners sitting beneath the structure," he says. He estimates there are anywhere from 3,500 to 4,000 total beneficial owners within ISLA's mandate.

Steele's charge is to "make sure JPMorgan is at the heart of ISLA's efforts in the global securities lending arena," he says. "The issues we address are many and varied, since our members are active in a number of countries and national markets."

Steele offers a recent example of how JPMorgan's involvement directly impacted clients and was aligned with their best interests. Ireland is a large center for offshore funds, many of which are active in securities lending. ISLA observed that current regulations in Ireland were not very transparent, and perhaps needed some updating to reflect current working practices in the industry. "What we did was approach the local market association, the Dublin Funds Industry Association (DFIA), and basically talked to them," explains Steele. "We came to an agreement that we'd jointly present to the Central Bank of Ireland in a helpful way with room for updating certain regulations that had not been reviewed in a decade," he says. "The Bank appreciated our approach, which is vital in opening lines of communication." This led to an ongoing dialogue with the Central Bank, and a successful conclusion wherein the Bank updated its regulatory notices in relation to securities lending. "Most of the impact was in the realm of collateral management, so many clients see our effort as a success in terms of helping the industry rest on a safer footing," says Steele. Further, Steele says that by clarifying regulations, "lenders could maximize their revenue potential from securities lending activity," explaining that some lenders had "held back from lending opportunities because prior to our effort, they were unclear on where the regulations stood on some points."

Improving and expanding on industry disclosure is another key focus for JPMorgan's work with industry groups, particularly with ISLA. "Much of our work scrutinizes the current level of disclosure in the marketplace and how clients could benefit from change," Steele says. One clear-cut example of this involved the recent discussion by the Financial Services Authority (FSA) regarding short selling. "ISLA and JPMorgan both contributed to the ongoing dialogue regarding this initiative," says Steele. In mid-2003, the FSA announced its case for greater disclosure for securities lending activity, specifically to offer more transparency to the overall activities in play. In the U.K., CRESTCo, the central depository there, recently began publishing some aggregate level information to inform the public on the scope of securities lending activity, without disclosing the actual individual investors behind that activity.

"This issue was interesting because we had to explain how there is a trade-off between the perceived benefits to investors of greater disclosure and the considerable cost implied if every single securities lending transaction had to be reported on an exchange," says Steele. "In the end, the outcome was essentially a good one, and dealt directly with improving transparency within the industry. This in itself will provide a benefit to the end investor."



As one of the largest agent lenders in the business, **we have a responsibility to our clients** to make sure we, and ultimately they, are up to speed on market developments and the like.

An Integral Part of Value Proposition

Seyboth and Steele's industry work, like Picone's, occurs over and above their senior level responsibilities at JPMorgan. Like Picone, they view their work with ISLA and ICI as a serious responsibility on which the firm's entire reputation rests. "Not all financial entities get involved the way we do," says Seyboth. "As one of the largest agent lenders in the business, we have a responsibility to our clients to make sure we, and ultimately they, are up to speed on market developments and the like. Our approach provides our client base with the necessary tools to help them make informed business decisions in a timely manner. Working actively with industry groups allows us to stay ahead of our competition and add true value to our client relationships."

Perhaps most important, JPMorgan considers actively leveraging its global reach as part of its promise to clients. "Part of our value proposition is that we assume this work for clients, essentially so they don't have to," says Picone.

Steele agrees, adding that the leverage JPMorgan offers its clients is substantial. "Let's put it this way, we never have to introduce ourselves at industry organization meetings," laughs Steele. "We have a large and formidable presence in the industry, and the global recognition that we are serious about protecting our clients' interests. That, in itself, has helped us become and stay at the forefront of the most significant issues facing our industry today." ○○○

battle of benchmarks

plexus' PAEG/L wins

by Mike Keady

Equity trading has become one of the most challenging jobs on Wall Street today. Traders must be sharp to seek out and find liquidity in an increasingly fragmented marketplace. But in an investing world, where no two trades are the same, the big question on many traders' mind is how does one determine the best benchmark for evaluating the quality of execution?

In 1988, Stephen Berkowitz, Dennis Logue and Eugene Noser, Jr. made the case for the VWAP, or Volume Weighted Average Price. VWAP has been called 'the easiest way to gauge a trader's performance.' Simply put, VWAP is the sum of the total number of dollars traded for every transaction (price times shares traded) divided by the total shares traded for the day.

Unfortunately, VWAP has its shortcomings. For instance, VWAP uses the same benchmark irrespective of trade size, whether the size is one million shares or 10 million shares. (Traders know that buying or selling in bulk can raise costs, since trades must be finessed through the markets.) Furthermore, at the extreme, very large trades can actually become the VWAP as they dominate the day's trading, corrupting the benchmark.

But VWAP's major failing is that it can be gamed. A trader could actually win the battle of beating a trading benchmark, but lose the war of maximizing portfolio performance. It's simple enough to accomplish; all a trader has to do is delay trades (or avoid them altogether) based on how they stack up against VWAP at the time. This suboptimal practice flies in the face of AIMR's best execution guidelines: Total returns to investors should never take a back seat to the cost to trade.

An appropriate benchmark is one that takes into account all the variables that a trader sees in the marketplace: momentum, volatility, order size, type of stock and trading volume. These factors all impact a trader's decision-making process from the time an order is received, until the broker sends back the final fill. The Plexus Average Execution Gain/Loss or PAEG/L® model computes expected cost from real end-to-end institutional transaction data. It answers the question: What did it cost my peers to execute trades in similar conditions?

The strategy of how to execute an order is dependent upon factors about the order itself and the marketplace's direction at the time the order was received. Clearly, order size and market capitalization — or ease of trading and liquidity — play a large role in deciding how and where to trade. To ignore these factors in the evaluation of these trades is ludicrous.

does your benchmark really help you

capture performance?

PAEG/L allows institutional investors to compare their trading experiences with their peers. By viewing how trades stack up against the averages, asset owners, managers and brokers can readily gauge their implementation process, anticipate costs and take proactive steps to reduce them. PAEG/L was created and is supported by Plexus Group, the most respected name in transactional performance analysis. PAEG/L is used by hundreds of top portfolio managers, traders and CIOs. Recently, the U.K. Financial Services Authority commissioned Plexus Group to assess the impact of its policies on the market using the PAEG/L. While AIMR's guidelines for investment managers recommends using contextual, peer-comparatives, readily accomplished using PAEG/L methodology to help evaluate and improve performance. For more information please refer to the Plexus Group commentary by Wayne Wagner, chairman and founder of Plexus Group, entitled "VWAP: Evaluation or Evasion?" at www.plexusgroup.com.

VOLUME WEIGHTED AVERAGE PRICE (VWAP)		PLEXUS AVERAGE EXECUTION GAIN/LOSS (PAEG/L)
VWAP encourages less informed clients to focus on reducing commission rates, not capturing greater returns.	1	PAEG/L shows clients the true total costs of trading, and why focusing only on commission rates may be counter-productive to true best execution.
VWAP is a static number, in that one benchmark must fit all.	2	PAEG/L is derived exclusively from institutional trading experiences, not from less relevant retail or day trading.
VWAP does not adjust for your order size and the real circumstances of trading.	3	PAEG/L recognizes and adjusts for real world trading experiences professional traders deal with everyday.
VWAP makes no distinction for investment style or strategy in its comparisons.	4	PAEG/L adjusts for the circumstances and style, such as growth, value, momentum.
VWAP does not consider the difficulty of trading your order.	5	PAEG/L incorporates the key factors of your trading challenges.
VWAP can be gamed, making the trader look good while simultaneously resulting in poorer investment performance.	6	Since PAEG/L represents the difficulty-adjusted cost of institutional trading, any trade that improves on PAEG/L represents value added to the portfolio.

PAEG/L answers the all important question:

What should it cost to make this trade

Historical review of categorized trade cost vs PAEG/L allows a trader to strategize: "Should I work it electronically on an ECN or through DOT? Give it to an upstairs desk to find the other side? Employ a direct access firm on the floor of the New York Stock Exchange? Let an upstairs broker work it as agent? Or use one of the several matching systems?"

It is these very complexities surrounding the effective marriage of investing and trading that prompted Plexus Group, a JPMorgan Investor Services Company, to create the PAEG/L. The PAEG/L puts trades into the actual context of the marketplace providing traders with valuable feedback to measure execution costs. PAEG/L quantifies what similar trades in similar situations have cost in the past and is derived from a statistical equation from Plexus Group's vast universe of trades from more than 150 money managers. PAEG/L answers the all important question: "What should it cost to make this trade?"

This rich database allows Plexus to build a robust peer-cost analysis system for its client base and provides PAEG/L with a wider lens to view and analyze trades in the marketplace.

In addition, PAEG/L comprises the institutional experience of dealing with liquidity factors — or liquidity constraints — that a trader faces in the marketplace. These include demand upon liquidity and the stock's momentum; percent of volume; size of order; and market capitalization. Consequently, if a trader is a seller into a rising market, the cost of execution will be less expensive than if the market were falling. Traders need an objective standard that adjusts for the difficulty of the order being executed. Common sense tells us that a very simple trade will cost less than a difficult trade. PAEG/L captures these variables.

As a Registered Investment Advisor to pension plans and money managers and not a brokerage firm, Plexus has no interest in advocating a particular way to trade. In contrast, VWAP is a trading technique as well as a benchmark. When the technique becomes the benchmark, the logic is circular and the meaning of the benchmark may lose relevance to the larger performance question.

But all in all, where trade sizes are small — relative to daily volume and markets are calm — VWAP is probably a decent measure. Unfortunately, this is the least interesting situation. VWAP works best when you need it least. Traders and managers want to know how well the tough trades are handled. The PAEG/L is indeed a fairer, more rational, realistic and reasonable measurement. Like the mechanic's calipers, it's the tool in the trader's toolbox that calibrates the fit of the trading tools needed to take on the toughest job on Wall Street. ○○○

For more information contact Mike Keady, managing director, Plexus Group at mkeady@plexusgroup.com or (201) 592-7674.

Plexus Group is a subsidiary of JPMorganChase.

succeeding amidst the **changes** and the **challenges**

an update from **JIM WILSON**

As 2003 comes to an end, conditions surrounding the securities lending markets offer new promise. Overall deal activity has increased, the yield curve has turned positive, and the pipeline for M&A and IPO deals appears favorable. Given the changes underscoring the securities lending industry, *Thought* magazine talked to Jim Wilson to gain insight into JPMorgan's investment outlook for the securities lending markets for the months to come. Jim is senior vice president and investment manager responsible for the asset allocation and risk strategies for the securities lending collateral investment portfolios and for investing cash collateral in excess of $85 billion on behalf of JPMorgan's clients.

***Thought* Magazine: After so many months of thin spreads and a negative yield curve, what is the current environment in the securities lending markets?**

Jim Wilson: On a basic level, it seems the marketplace has come to the conclusion that further cuts in interest rates are highly unlikely. This perception was emboldened by the Federal Reserve's decision in August to leave the overnight rate unchanged at 1%. Obviously, if we were to experience another catastrophic event such as 9/11, then all bets are off.

That being said, the underlying foundation of an economic recovery, matched with what appears to be a solid — albeit slow — rebound in the U.S. equity markets and an historically low inflation environment, have helped alleviate some of the difficulties that have plagued the securities lending arena for quite some time. In the third quarter of this year, we saw overall market activity pick up with heightened volatility. As our clients know, we crave volatility, in that it feeds deal opportunities.

We've seen more pockets of opportunity on the cash side, with more arbitrage activity and more diversion in rates between borrowers and lenders. This led to some attractive spreads, particularly at the end of the third quarter, another good sign that investors are re-entering the market and seeking to reposition their cash. We also put out some term trades at the end of the quarter, those have been virtually non-existent over the past nine months.

Are you convinced economic recovery is imminent?

While nothing is guaranteed, we're really only missing one key catalyst to secure — in investors' minds — a solid recovery, and that's employment data. The tax relief effort of the current administration put money back in consumers' hands, and the general consensus is, most of that money was spent in July and August. In late September, economists' previous expectations of 1.0% economic growth in the second quarter were sheepishly eclipsed by the actual 3.3% figure. On top of that, the forecasts for the third quarter are substantially stronger, at more than 5.0% GDP growth. Admittedly, the labor market shows a weak pulse, and year-over-year changes in personal income warrant surveillance. But with the exception of a marked improvement in employment numbers, the U.S. economy has exhibited clear signs of a sustainable recovery, and therefore, it is likely that rates will continue to trend upward from here. However, we do believe the most dramatic movement in rates is behind us. That is to say, if rates continue to rise, as we expect, they will do so in a less pronounced way than what we saw from June through October, for example.

These issues, however, seem less foreboding given the outlook for corporate profits, production and increased demand, and especially, with corporate balance sheets on a stronger footing. What's more, we've seen a sharp decrease in the number of credit downgrades this year. This is one of the factors contributing to the narrowing of credit spreads, which typically tends to be a sign that the economy is stabilizing. You don't see downgrades fall off in times of economic crisis — quite the opposite. Given all of this, we hold fast to a stance of mildly cautious optimism.

How have you coped with a continued low interest rate environment?

We've actually seen some positive trends emerge for us. First, on a month-to-month basis, we've seen significant growth in our business. Our outstanding fixed income balances in particular, are the highest they've ever been. Second, we've placed even greater emphasis on working closely with our trading desks to maximize utilization, but always with an eye to the bottom line. We continually seek to add value to each transaction on top of increasing utilization, whether through maximizing returns on existing business or through reinvestment.

We believe this low interest rate environment has worked in our clients' favor. This can be partly attributed to our business model, known to be relatively conservative. For example, while we often heard from prospects that our revenue estimates were generally more modest than some of our competitors, those same prospects are asking why our estimates are coming in a bit stronger.

Our strategy has always been to provide clients with consistent returns, rather than trying to hit home runs. We calculate estimates based on reasonable assumptions over a period of time. Our clients generally aren't looking to hire us for short periods, but instead over several years, to establish a long-term securities lending relationship. So, even though rates are low, we try to assign some stable values to what we believe specials and Treasuries are worth, percentage amounts out on loan and what expected historic returns will be within reasonable guidelines. Given the fact that prospects are asking why our estimates are stronger than those of some competitors, I suspect that either some of those firms are still experiencing the sticker shock of historically low interest rates; or they're having more difficulty figuring out how to put the securities in their portfolio to work.

So it seems JPMorgan's conservative stance proved to be beneficial in these times.

Absolutely. Our program always appeals to clients and prospects when things are stable. It's when rates are moving to the extremes that some of our competitors' programs seem more attractive. However, we're not going to ask our clients to take on unnecessary interest rate risk to win business. Let's face it — if you take a lot of interest rate risk and rates fall, you hit a home run. However, it's likely that the clients weren't compensated for the proportionate risk taken on their behalf.

You mentioned that collateral flexibility is crucial to lenders as interest rates remain historically low and a sluggish deal environment prevails. Will that change if and when rates trend up?

The securities lending industry is evolving independent of where rates go. Certainly, we stress to clients to consider alternate forms of collateral in order to create additional opportunities for them in a thin-spread environment — but always respecting their specified risk/return parameters.

We're trying to help clients realize that we can keep their securities working at an acceptable spread

Our strategy has always been to provide clients with consistent returns, rather than trying to hit home runs

Recognizing that there may be some classes that we've overlooked in the past, from a collateral standpoint, we're currently considering ways to benefit our program and are allowing more securities to be out on loan. If we're willing to buy a company's commercial paper on an unsecured basis, we also have to consider doing more types of business with that firm on a collateralized basis. With capital requirements currently changing with Basel II (see also page 8, "Other Initiatives", for more information), banks will have the latitude to be much more creative with the types of securities they take as collateral, and what they're allowed to indemnify their clients against. At one time, it was Treasuries or agencies, period. Today, we're closer to being able to offer indemnity all the way through equity collateral.

Does this change seem unsettling to you?

It has allowed many smaller, boutique firms to enter the industry and compete, but it has also created more opportunity for us. These smaller lenders tend to be much more creative in terms of the collateral they accept. By their willingness to do what established lenders shy away from these firms elbow their way into the business and attempt to drive a wedge between the borrowers and us. By comparing what we do versus what a smaller, newer third-party lender does, and then factoring in how much capital we have behind our indemnity, you get a more accurate feel for how much risk you'd take in your portfolio.

Are you currently considering any new investment vehicles?

Yes. We're looking at new types of collateral to take under reverse repo. If we can broaden what we can indemnify on the lending side, then we will be equally interested in offering that same type of investment to our customers. For example, fixed income securities as well as equities from developed markets.

On other fronts, we're considering our expectations for the yield curve and consequently, we're shifting our focus from fed funds floaters to LIBOR-based floaters. First, any positive slope in the curve would favor LIBOR floaters, and we anticipate this type of movement in the months to come. Second, the spread with which we've been able to buy fed funds floaters has tightened to where we're not deriving the benefit we did previously, when these vehicles were yielding 12 to 15 basis points over fed funds. So in addition to our expectations for the yield curve, we simply needed to find a different investment option based on return. We are also looking at expanding our final maturity criteria to three years for certain credits. This is in recognition that there is an additional yield pickup of five plus basis points for the added year.

Do you have a final year end message for clients?

Clients are beginning to realize that utilization isn't the sole way to increase or maintain revenue. Spreads have virtually shrunk and the business has become much more commoditized. As a result, many savvy clients are asking themselves if they want to keep reaching for revenue in the short term or if they'd rather hold fast to their risk/return guidelines and stay safe while the revenue continues. Many of our clients are now reconsidering the risk/return trade-off and are coming back into JPMorgan's program as a result of our stringent, albeit conservative, approach.

At the same time, we do not encourage clients to take on a large amount of additional risk, but instead ask them to consider different types of risk. By allowing JPMorgan to bridge from pure Treasury risk to something high enough in credit quality, the client is focusing more on putting their securities to work beyond the Treasury reinvestment side of the business. We're trying to help clients realize that we can keep their securities working at an acceptable spread in an environment where specials are not driving the process. That's been a formidable challenge, but it's working.

While we anticipate continued improvement in overall conditions in the months ahead, it certainly won't be a free ride. We know that as our operations become more streamlined and electronic. The cost of writing a ticket has dramatically decreased. That has helped us handle greater volume at lower costs, a benefit we can pass on to our clients. All of this makes for exciting times, amidst the change and the challenges. The good news is, JPMorgan possesses the depth, breadth and global reach to rise to just about any shift in the marketplace and continually meet our clients' dynamic needs. ○○○

IN AN ENVIRONMENT WHERE SPECIALS ARE NOT DRIVING THE PROCESS

It is no secret that the financial services industry has faced ongoing challenges during this most recent bear market. Awaiting economic recovery may be difficult, as companies face cost cutting, delays in capital expenditures and even elimination of simple projects. Everyone knows that the financial markets are cyclical, but plans for success should not be put on hold. Working to offer clients innovative and creative solutions is the hallmark of global business leadership no matter what the market's direction.

a collaboration produces solutions

rooted in client needs

Asking the Question

At an annual relationship review meeting with CNA Insurance, Marilou McGirr, vice president Investments and Treasury for CNA, advised JPMorgan Investor Services (JPMIS) that CNA needed to rethink trade support for its mortgage-backed securities (MBS) portfolio. In particular, how it managed its mortgage allocation operations. At that point in time, CNA was using another service provider for this support and related custody, and the decision was made to either *in-source* the function or to find a new external provider. During this meeting, CNA's relationship manager, Bob Fredericks, vice president, Investor Services' North American Insurance Group, pointed out that, "it wasn't a service that Investor Services provided at that time, but that we understood the process and would like to consult with CNA on potential solutions." Fredericks continues, "One of the significant benefits that JPMorgan offers its clients is access to a depth of investment expertise and intellectual capital that is unmatched in the industry. With the right partner, we might be able to develop a solution that addressed CNA's needs, and it was important to ask if we could assist."

An active Agency investor, CNA was buying and selling pools on what's known as a TBA or *To Be Announced* basis. The complexity of the transaction is inherent in the nature of the TBA contract. While the client knows the value of the contract, most other details about the underlying securities, including the specific pools that constitute them, will be announced only on settlement day. What is abundantly clear to the investor is that, as a result of buying the contract, one or more of its investment guidelines, like the weighted average maturity of the portfolio, will be breached and need to be addressed.

To continue with the above example, investment management might want its portfolio to maintain an average maturity of 20 years. Once the contract settles and the pools are received, the portfolio's average maturity will either rise above or fall beneath this guideline and, most likely, other guidelines, like weighted average duration, as well.

The solution lies on the sale side, with the contracts that the client sells in the TBA market and the delivery of pools by the client to its various counterparties on settlement day. "This kind of transaction," according to Mark Catalano, vice president and head of MBS Operations at JPMorgan Securities Inc. (JPMSI), "requires unique and highly specialized middle office processing."

Looking to upgrade the level of service they were currently receiving, CNA was in the market for a new allocation provider. Fredericks says, "At first, the team considered creating a system for CNA from scratch, but we knew that as a major player in the mortgage-backed securities markets that experts existed within JPMorgan to whom we could turn for advice and, perhaps, a product." As such, the team set out to find a partner to help them provide CNA with a solution.

Home Was the Answer

With a team whose expertise averaged 15 years in the mortgage arena and a state of the art allocation system already in place, JPMSI made an excellent and logical choice for such a partner. By taking the existing platform and adding to it the requisite firewalls and third party security, the new JPMIS/JPMSI project team transformed this internal system into a multi-customer solution unique to JPMorgan. "As far as we know," says Fredericks, "we're the only major investor services provider offering a product of this kind." According to Catalano, "The system is highly flexible from a user perspective. It maintains a comprehensive reference database, and offers clients the ability to create customized queries and reports." The system also features high levels of connectivity with real time interfaces to FICC (Fixed Income Clearing Board) for mortgage backed securities netting as well as BDAS, JPMIS' real time broker-dealer clearance system.

"Before CNA made the decision to change providers we considered building our own system," said CNA's McGirr. Why they didn't is fairly straightforward. "In addition to substantial expenses associated with building an internal system from scratch," says Catalano, "the cost of maintaining the system and the operational staff necessary to process the accompanying trades can be prohibitively expensive."

CNA's McGirr continues, "JPMSI's team includes experts with extensive years of experience in the business. Their demonstrated capability to handle enormous transaction volumes and the complexity of details associated with TBA contracts, combined with the ability to communicate with us to the level necessary to properly and efficiently process these pools, was a huge factor in our decision to go with JPMorgan as our Mortgage Optimization provider.

"TBA contracts have been around since the 1980s," says McGirr, "but the complexity of the settlement process has discouraged some investors from getting involved. Many of our industry colleagues have asked the question — How can we do this? JPMorgan has provided an answer."

ONE OF THE SIGNIFICANT BENEFITS THAT JPMORGAN OFFERS ITS CLIENTS IS **ACCESS TO A DEPTH OF INVESTMENT EXPERTISE AND INTELLECTUAL CAPITAL** THAT IS UNMATCHED IN THE INDUSTRY

A Win Win Situation

In addition to obvious opportunities that a solution like this creates for JPMorgan, including higher revenues from operating services and trading, the benefits to its clients are equally as considerable. The mortgage optimization processing service, scheduled for implementation in December of this year, is expected to cut CNA's mortgage allocation expenses literally in half. McGirr observes, "By consolidating our activity with JPMorgan, CNA will improve its business efficiencies, by cutting costs and improving operational effectiveness." To which, Catalano adds, "CNA now has a pay as they go option with access to a sophisticated piece of technology that's fully integrated with a Broker Dealer's real time clearance platform."

The First of Many Collaborations

The JPMIS/JPMSI team is working closely together with insurance clients to offer other products in the coming months, including a suite of MBS financing products that can be used as alternatives to commercial paper issuance or traditional bank credit facilities for short-term funding purposes. Look to future issues of *Thought* for more details on this new suite of products.

Industry Confirmation

JPMorgan Investor Services Insurance Advisory Board (IAB) meetings have been the incubator for many of the kind of creative solutions businesses must develop to stay at the forefront of innovation. The IAB (see also *Thought* Q2/2003, page 8 "Innovative Forums Lead to Client Focused Solutions") is a highly consultative approach to developing unique solutions that are rooted in client needs. Comprised of 16 key Investor Services clients, the IAB works to share knowledge, present new ideas and address challenges, with the ultimate intention of creating client focused solutions to improve the way JPMorgan and its clients execute vital business functions.

At the last meeting of the IAB in September, Joe Blauvelt, managing director, and Mike Garrett, vice president, of JPMSI, consulted with the Board's members on these and other potential products. "We left the meeting," Blauvelt says, "very pleased with strong indications that our product ideas were on the right track as well as the insights we need to make them even better." Jim Putnam, senior vice president and business executive for North American Insurance, observes that "the results from the Advisory Board combined with the partnership between JPMIS and JPMSI offer a great deal of continued potential. Some of the products are currently still in the initial stages, but we've presented services like the Mortgage Allocation Program at the Board meetings and they have been well received." The partnership clearly demonstrates JPMorgan's strength in terms of leveraging and realizing synergies, and is the beginning of what the two teams expect to be many successful future collaborations. ○○○

managing currency risk in global portfolios

By John Normand,
Global Fixed Income
and Foreign Exchange
Strategist,
JPMorganChase

The Strategic vs Tactical Decision

Currency risk is an inevitable by-product of international investing. How investors choose to manage this risk is both a strategic (long-term benchmark) and tactical (short-term deviation from the benchmark) decision. From a strategic perspective, the conventional wisdom is that currency exposure is all risk and no return. If exchange rate movements offset interest rate differentials between countries, then there is no long-term gain from passively assuming currency risk. (This argument tends to hold more for major currencies than emerging markets, however.) At the same time, currencies tend to be as volatile as equities and two to three times more volatile than bond markets (see charts), which exposes investors to substantial mark-to-market risk over shorter horizons.

Given this risk-return profile, many investors are reluctant to take active currency risk. Most bond investors either fully hedge currency exposure (arguing that currency exposure is uncompensated volatility), or take far less tactical risk in FX than they do in fixed income. By contrast, the majority of equity investors leave foreign exposure unhedged, assuming that currency movements wash out over the long run, or that forecasting short-term currency movements is beyond their core expertise. Neither extreme is optimal, however. Full hedging eliminates the potential short-term gains from tactical trading, while unhedged exposure leaves investors vulnerable to substantial volatility. The optimal hedge ratio typically lies somewhere in between, and varies by investor and over time.

Further, industry performance figures indicate that those managers who actively manage currency exposure — overlay specialists — have tended to generate higher excess returns (alpha) than active fund managers in traditional domestic asset classes. A study by the consultancy Russell Mellon showed that the median FX overlay manager has generated a return/risk ratio (information ratio) of 0.50 over the past decade, higher than that earned by the median global fixed income manager (0.40), domestic bond manager (0.30) or global equity manager (0.0). These numbers run counter to the perception that FX markets are priced efficiently (being large and liquid), and are, therefore, not a source of excess returns.

Which Risks to Take

There is no ironclad rule on which approach to tactical FX trading yields superior returns. In FX, as in any asset market, there are multiple trading styles such as fundamental vs. technical, momentum vs. contrarian, directional vs. relative value, G-7 vs. emerging markets.

Two general principles of active currency management do apply, however: managers should diversify their approaches as much as their trades, and managers should employ quantitative frameworks to discipline the investment process. Towards this end, JPMorgan FX Research has formalized a set of trading models to capture three short- and medium-term drivers of currency markets: risk appetite, fundamentals and flows/positions. These models are not intended to substitute for judgement — particularly where structural breaks or policy shifts are emerging — but rather, to complement it. They are deliberately simple, focusing on trading rules rather than econometrics, and on direction rather than magnitude.

Trading Risk Appetite

The core model is the Liquidity, Credit and Volatility Index, or LCVI, which tracks shifts in risk appetite signaled by movements in market liquidity, credit spreads and volatility. The rationale for tracking risk appetite is that currencies respond to sentiment shifts in a systematic fashion. When risk appetite rises (falls), high-yield currencies tend to appreciate (depreciate) as investors seek to earn/carry (repatriate capital). This capital flow dynamic can be reinforced by a country's current account balance. Current account deficit countries such as the U.S. are capital importers (by definition), so the stability of their currencies depends on risk appetite remaining sufficiently robust to attract portfolio flows. When risk aversion rises and cross-border flows reverse, the currencies of current account deficit countries tend to fall, while those of current account surplus countries (such as Japan), tend to appreciate.

There is no ironclad rule on which approach to tactical FX trading yields superior returns.

Annualized Volatility on Hedged vs Unhedged Returns, USD terms 1986–2001

Source: JPMorganChase

With a measure of risk appetite such as the LCVI, we can then derive tactical trading strategies which vary by risk climate. For example, when the LCVI is in risk-seeking mode, the model recommends buying the currency of high-yielding, capital-importing countries (such as Australia) against the currency of low-yielding, capital-exporting countries (Japan). Over the past five years, this trading rule has generated an information ratio of 1.8 (before transaction costs).

Trading Fundamentals

A more medium-term driver of currencies is growth perceptions, which influence currency markets through their impact on expected asset price returns. Rather than measure actual economic momentum, we focus on economic surprises (the difference between actual data releases and consensus expectations), since only new information should impact asset prices in a reasonably efficient market. Using a set of 25 U.S. activity data releases (such as the ISM survey, jobless claims, etc.), we compared the market's forecast error to its historical average, to define an "economic surprise" (as opposed to simple noise). We then cumulate these surprises over the past month to arrive at an Economic Activity Surprise Index (EASI), which signals the balance of growth perceptions in the market. A preponderance of positive surprises signals growth optimism and generates a signal to buy the U.S. dollar, while a skew towards negative surprises signals growth pessimism and generates a sell USD signal. Over the past five years, this strategy has generated an information ratio of 1.25.

Trading Positions

Although the LCVI and EASI have a strong track record, they run the risk of missing turning points, since they are essentially momentum gauges. To capture prospective trend reversals, we devised Sentiment and Flow Indices (SFI), a composite indicator of market positioning comprising risk reversals, IMM positions, client flows and the mergers and acquisitions pipeline. When the SFI indicates that a currency is overbought (oversold), the model recommends being short (long). Trading this approach over the past five years has generated an information ratio of 0.50.

Diversification of Approaches

These three approaches are not meant to be exhaustive. Managers could — and should — employ other strategies such as price-based technicals or event-driven strategies (particularly in emerging markets). Again, there is no rule as to which approach is best: any is legitimate as long as each has a positive information ratio on its own. But our experience in JPMorgan's model portfolio (run for the past six years in our flagship publication Global Markets Outlook and Strategy) has been that a more diversified, multi-factor approach combining fundamentals, risk appetite and technicals, tends to outperform narrower, single-factor styles. And in all cases, starting with a model and overlaying judgement have tended to impose more discipline and consistency to currency management than a purely discretionary approach. ○○○

technology

JPMorgan message express

optimizing messaging efficiency in today's financial markets

Financial Institutions face a dilemma as the cost of setting up and maintaining facilities to manage message flows between counterparties is becoming increasingly costly and burdensome. In an environment where investment capital is limited firms are looking for innovative solutions to solve their message management woes. The solution: JPMorgan Message Express℠.

JPMorgan Investor Services recently launched JPMorgan Message Express, a robust message management service that provides financial institutions with links to industry messaging utilities without the technology costs associated with the multiple and changing requirements of industry and counter-party standards.

JPMorgan Message Express offers integrated end-to-end, pre- and post-trade straight-through processing (STP) solutions with multiple link capabilities. With Message Express, clients can view transaction states and information regarding settlement instructions, create reports and enter messages online via JPMorgan ACCESS℠, JPMorgan's Web gateway for clients. Users can monitor and manage all incoming and outgoing messages real time, with the ability to drill down into specific messages, ultimately simplifying their workloads while providing quicker access to information.

A SWIFT Service Bureau designation allows Message Express to facilitate STP for clients by providing outsourced SWIFT connectivity, facilities management, disaster recovery and value-added data processing services. And as a SWIFT Electronic Trade Confirmation Service Provider, JPMorgan Message Express acts as an agent on behalf of clients to exchange electronic trade confirmation messages with matching and confirmation services such as Omgeo Central Trade Manager℠ (Omgeo CTM) as well as send settlement instructions over SWIFTNet. (See also *Thought* Q2/2003, page 28, "Give Some Thought to SwiftNet".)

Chuck Wiley, Manager, Securities Industry Division for SWIFT Pan-Americas, Inc. in New York, said, "Growing the core base of SWIFT users beyond the current 7,500 users in 200 countries is based in large part on the increasing availability of indirect connectivity options such as Service Bureaus. As one of the largest users of SWIFT's global messaging infrastructure, JPMorgan is ideally placed to offer Service Bureau-based connectivity to SWIFTNet and to meet the growing market demand for lower-cost connectivity. JPMorgan Message Express provides a suite of solutions that promote STP and integrates end-users' front and back-office processes with services such as FIX and SWIFT."

Other JPMorgan Message Express features include:

- Acts as a single connection between a firm's internal systems and industry utilities such as SWIFT and FIX, as well as to matching utilities such as Omgeo.
- Provides settlement status monitoring and corporate actions processing.
- Offers routing service that enables firms to send and receive transactions and offers market event and settlement status messages to and from custodians and other external parties.

Clients can access Message Express through JPMorgan ACCESS℠. The application has a dashboard view with the ability to drill down into individual transactions.

- Provides enrichment, management, maintenance and population of industry Standard Settlement Instruction (SSI) databases with connectivity to industry databases such as Omgeo ALERT℠.
- Accepts data in multiple formats, translates the information into structured message types and industry-accepted standards such as XML and ISO 15022.
- Provides links to the JPMorgan Global Foreign Exchange Trade Desk for FX execution and confirmation.

Optimizing Efficiency

JPMorgan Message Express simplifies a client's operating model by providing a centralized solution for translating, transforming and transmitting messages with the full middleware capacity to validate, reformat and enrich messages. Message Express offers clients the ability to handle complex message requirements, without the investment in staff and technology to support such a complex message management operation.

"An increasing number of financial institutions are turning to global providers like JPMorgan for outsourcing solutions that can help them increase their competitive advantage. JPMorgan Message Express allows them to reduce operating costs, manage risk and avoid large, multi-year investments in service delivery platforms. By freeing up staff and investment dollars for tasks more critical to their key objectives, investment managers are able to focus more on generating high-quality revenues," says Paula Sausville-Arthus, senior vice president, Asset Manager Solutions Group, JPMorgan Investor Services.

JPMorgan Message Express offers cost effective solutions with substantial benefits to investment managers and service providers. Those benefits include:

Expense Savings

- Reduces capital expenditures on middleware, messaging applications, and costly industry upgrades
- Creates potential for lowering operating cost per transaction
- Eliminates manual processing and increases automation and STP, providing long-term financial savings
- Eliminates hardware, licensing and maintenance resources for SWIFT connectivity
- Provides resources for testing and set up with third party providers
- Includes disaster recovery services

Growth & Efficiencies

- Links seamlessly with other JPMorgan services to allow flexibility in implementing outsourcing solutions
- Supports integration of multiple internal applications
- Centralizes data transmissions and communications to multiple providers through a single connection
- Leverages JPMorgan's strategic architecture, global scale and flexibility

"Outsourcing is a growing trend around the globe that we are actively working to address with global custodians to best provide solutions that fit their needs and the needs of their customers. Outsourced STP solutions often provide an alternative and very cost-effective way for investment managers to improve operational efficiencies and lower the costs and risks along the entire trade lifecycle," adds Jim Casey, managing director of Global Product Management and Marketing of Omgeo. "We are excited to continue expanding our relationship with JPMorgan and see this offering and their participation in our Americas Advisory Board as two clear indications of our successful partnership."

A Proven Partner

Capitalizing on the firm's significant scale and reliable architecture, JPMorgan Message Express solves financial institutions' increasingly complex message management challenges including achieving STP, managing risk, reducing costs, improving efficiencies, managing multiparty communications, integrating applications and keeping up with changing standards. ○○○

For more information about Message Express contact your JPMorgan relationship manager or client service officer.

accurate reference data is key to STP

A STUDY CONDUCTED BY TOWERGROUP RECENTLY REVEALED THAT FOUR OUT OF FIVE FINANCIAL SERVICES FIRMS BELIEVE POORLY MANAGED REFERENCE DATA IS A KEY CAUSE OF INTERNAL STRAIGHT-THROUGH PROCESSING (STP) FAILURE. THE STUDY ALSO REPORTED THAT **30% OF FAILED TRADES RESULT FROM POOR DATA MANAGEMENT.** UNFORTUNATELY, FINDING RELIABLE REFERENCE DATA IS CONSIDERED A CHALLENGING, INEFFICIENT AND COSTLY TASK FOR FINANCIAL SERVICES FIRMS.

Yet the TowerGroup's statistics illustrate why quality reference data and strong data management have become so important.

As a result, financial firms face difficult choices. While businesses continue to work to trim their budgets, creating their own costly reference data solution is often not an option. However, with the continued trend toward STP and further automation, reliable reference data is increasingly becoming a necessity.

To support asset managers in meeting their goal of establishing data consistency across core applications, JPMorgan offers Global Market Reference Data (GMRD). The product, to be offered in early 2004, is a single, global repository that holds approximately 4.5 million securities covering all asset classes. To date, there are more than 2.2 million securities that have been systematically validated by over 900 business rules with an automated second source validation on key attributes. In addition, GMRD features real-time publication of new securities added and/or updated to the database.

"We take multiple vendor feeds and through a series of rules and hierarchies create a composite record. Related attributes are driven by the asset classification, such as interest rate and maturities rate for a fixed-income instrument," says Anthony Rizzi, vice president and product manager for GMRD. "By centralizing the capture, cleansing and delivery of asset indicative data, GMRD eliminates the portfolio and maintenance backlog associated with using multiple numbers of warehousing data systems," he adds. Other key features of GMRD include:

- Vendor data is merged following a predefined hierarchy and systematically scrubbed through business rules
- Assets that pass the business rules are posted to the GMRD Security Master
- GMRD then provides data via real-time messages to subscriber applications
- Assets that do not pass the rules are sent to a WorkQueue. This serves as an electronic in-basket and automatically prioritizes the WorkItems

Centralizing reference data is among the most effective ways to manage information and thereby improve STP rates. JPMorgan's GMRD service can help to solve data management issues, improve the quality and accuracy of accounting data and reduce overall operational risk, without the costly expenditures associated with building a proprietary system. ○○○

new corporate action dial-in forums

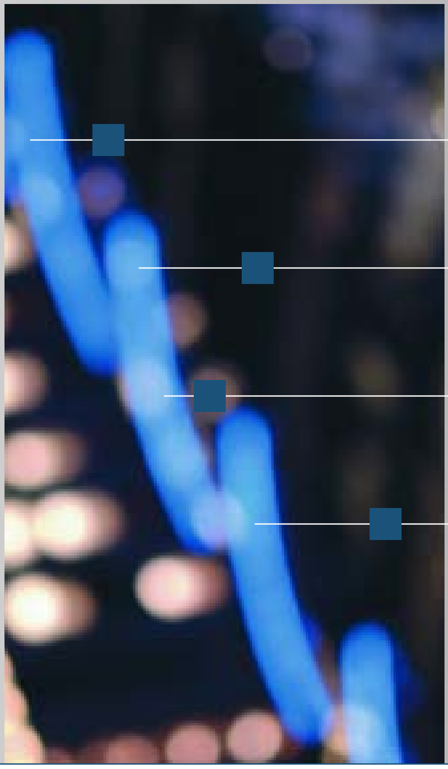
work to increase clients' knowledge

CORPORATE ACTIONS ARE FREQUENTLY CITED WITHIN THE SECURITIES INDUSTRY AS A MAJOR SOURCE OF PROCESSING ERRORS, RESULTING IN SUBSTANTIAL OPERATIONAL LOSSES. JPMORGAN INVESTOR SERVICES *Global Corporate Action Dial-in Forums* ARE DESIGNED TO **ENHANCE KNOWLEDGE OF COMPLEX CORPORATE ACTIONS AND HELP REDUCE THE POTENTIAL FOR ERRORS AND LOSSES.** MANY INDUSTRY GROUPS ARE ACTIVELY WORKING TO FURTHER STANDARDIZE AND IMPROVE CORPORATE ACTION NOTIFICATION AND PROCESSING, INCLUDING THE GROUP OF THIRTY (G30). JPMORGAN'S CORPORATE ACTION DIAL-IN FORUMS COMPLEMENT THESE EFFORTS.

"Complex corporate action processing can bring challenges for many industry participants so we have created an interactive dial-in forum to provide our clients with clarity and training for the more unusual and troublesome events," said Jon Divis, Securities Processing Executive, JPMorgan Investor Services. "As a client-focused organization that makes service excellence a top priority, we believe we can add value for our clients by breaking down the events into easy to understand components presented in open forums using clear presentation materials."

Investor Services' Network Management Group already holds dial-in forums for clients on market-related information, industry developments and tax & regulatory issues that are very popular with clients. Corporate Action Forums will take place on at least a bi-monthly basis and focus on seasonal and market-specific corporate action event types. Two sessions have taken place since the launch in October with participants dialing in from around the globe. ○○○

For more information, please contact
Clyde Piercy (44-120) 234-7723
or Sarah Johnson (44-120) 234-6075.



In order to keep clients well informed of key topics of concern for the foreign investment community, Investor Services Network Management hosts *Dial-in Forums* on a broad range of topics throughout the year. 2003's topics included a myriad of subjects from market related information and developments, industry news, and tax and regulatory Issues. In addition to the existing agenda, this year we are pleased to introduce Corporate Actions Dial-ins. See page 27 for more details on this new and exciting addition to our agenda for clients. For information on these and future events, contact: elizabeth.fortier@jpmorgan.com

network timeline 2003

January

Industry Initiatives Roundtable

Hosted by Ed Neeck

JPMorgan Investor Services Network and Product Management Executive, New York

A panel of experts provided clients with an overview on several important industry developments. Topics included: T+1, Virtual Matching Utilities, European Consolidation and Group of Thirty (G30). The program focused on key concepts of the international securities industry, the global marketplace, global custody and emerging markets. **Also held in April, June, September and November.**

February

Active Global Proxy Service

Hosted by Clyde Piercy

JPMorgan Investor Services Custody Product Management, U.K.

Clients were provided with an overview of JPMorgan's enhanced Proxy Voting Service via ISS. Key features of the product were reviewed, and clients had the opportunity to ask questions about the new launch.

International Securities Market Training

Hosted by Abigail Luster

JPMorgan Investor Services Network Management, London

A one-day seminar program of four modules with short interactive segments delivered in a classroom setting.

March

India Roundtable

Hosted by Suneet Luthra

JPMorgan Investor Services Network Management, Asia

In advance of the move to T+2 settlement in India, clients were provided with detailed information about the implementation plan, and what the key benefits and impacts are to foreign investors. In addition, our market experts shared information about other key developments that are expected in the Indian securities market.

China

Hosted by Adam Vine

JPMorgan Investor Services Network Management, New York

Clients were invited to participate in a discussion on the introduction of the China A Shares market for foreign investors. Detailed information was provided about this major market development, and clients had the opportunity to pose questions to market experts.

April

United States and United Kingdom Tax Treaty

Hosted by Chris Gilbert and Ruth Rosenhaus

JPMorgan Investor Services Tax Product Management, London and New York

A panel of experts provided clients with detailed information about the new income tax treaty that came into force between the U.S. and the U.K. Clients were provided information about the specific provisions ratified under the treaty.

May

European Union Savings Directive

Hosted by Chris Gilbert

JPMorgan Investor Services Tax Product Management, London

Clients were invited to participate in a discussion with our tax experts about an important development in Europe. A summary of the European Union (EU) Directive on the taxation of savings income, as well as information about the reporting and withholding responsibilities of paying agents in the EU member states was provided. A question and answer session followed.

International Securities Market and Cross Border Tax Training

Hosted By Beth Fortier

JPMorgan Investor Services Network Management, New York

The first day of the seminar consisted of four modules with short interactive segments delivered in a classroom setting. The program focuses on key concepts of the international securities industry, the global marketplace, global custody and emerging markets. The second day consists of a half-day session focusing on taxation of cross border investments and was delivered by Ruth Rosenhaus of JPMorgan Investor Services Global Tax Products.

June

Poland and Germany

Hosted by Andrew Bond and Peter Pedersen

JPMorgan Investor Services Network Management, London

Our Network Managers joined clients in a discussion about two key developments in Europe. First, the implementation of the Central Counterparty in Germany and then a detailed overview of the new securities regulation in Poland, Article 34A, and its implications followed.

Meeting with Indian Depositories

Hosted in Partnership with Standard Chartered Bank

JPMorgan clients were invited to join a dialogue with representatives from the Central Securities Depositories in India. Information was provided about key market developments, and clients were afforded an opportunity to ask questions and share feedback with the local market participants.

United States Income Tax Changes

Hosted by Frank Seyboth and Ruth Rosenhaus

JPMorgan Investor Services Fund Services and Tax Product Management, Boston and New York

A panel of experts from JPMorgan provided clients with information about changes to the U.S. income tax rates applicable on dividend and capital gains. An overview of the changes, plus details about specific impact was presented.

July

Industry Initiatives Roundtable

Hosted by Ed Neeck

JPMorgan Investor Services Network and Product Management Executive, New York

A panel of experts provided clients with an overview on several important industry developments. Topics included: G30, European Consolidation, Virtual Matching Utilities and U.S. CMO Process Improvements.

Meeting with the Thailand Depository

Hosted by Standard Chartered Bank

JPMorgan clients were invited to join a dialogue with representatives from the Central Securities Depositories in Thailand. Information about key market developments was provided, and clients had the opportunity to ask questions and share feedback with the local market participants.

October

Taiwan Liberalization

Hosted by Rees Browne

JPMorgan Investor Services Network Management, Hong Kong

Clients were provided with a detailed review of major changes in Taiwan affecting the foreign investment community. A Q&A session followed a discussion about the changes and how they impacted clients.

Global Corporate Actions

Hosted by Sarah Johnson

JPMorgan Investor Services Corporate Actions, Bournemouth

Our newest addition to the dial-in forum series, the Global Corporate Actions Dial-in, commenced with a discussion on Australian Dividend Reinvestment Plans. Clients were provided with an overview on key concepts relating to this corporate action type, and had an opportunity to ask questions of our experts. ○○○

inthepress

"As fund managers continue to pare back operations to concentrate on their core competencies — asset gathering, investment management, and client servicing, they are looking for innovative, cost-effective solutions for those functions that are critical but non-core. If they can plug into specialist products that help them to reduce risk and streamline administration, while enhancing their ability to take on and service new business, then they must consider the opportunity very seriously."

TONY CAREY, SENIOR VICE PRESIDENT, FUNDS SERVICES, JPMORGAN INVESTOR SERVICES EMEA
FINANCIAL TIMES MANDATE, OCTOBER 1, 2003

Investor Services has launched a new settlement interface that allows trades confirmed in Omgeo Central Trade Manager to be instructed directly to JPMorgan. The move makes JPMIS the first custodian to adopt a full straight-through processing solution with Omgeo based on ISO 15022 messages. "We have worked very closely with Omgeo to build this innovative new service and we are delighted to be able to further help our clients achieve their STP goals and respond to industry needs."

NEIL HENDERSON, SENIOR VICE PRESIDENT, SECURITIES PROCESSING AND FUND SERVICES EXECUTIVE, JPMORGAN INVESTOR SERVICES
INTERNATIONAL CUSTODY AND FUND ADMINISTRATION, OCTOBER 1, 2003

"The expansion of the Dallas site is intended to further strengthen JPMorgan's already robust out-of-region service capabilities. JPMorgan's long-term strategy is to address business continuity planning requirements by establishing and maintaining active sites which run concurrently on a day-to-day basis along with the New York region's sites."

ALLEN B. CLARK, SENIOR VICE PRESIDENT, BROKER DEALER SERVICES EXECUTIVE, JPMORGAN INVESTOR SERVICES
SECURITIES INDUSTRY NEWS, SEPTEMBER 29, 2003

"Fund managers are looking at their accounting and other back and middle office services and asking themselves if it makes sense to continue doing them in-house." Swayne adds that, "As investors in Europe and elsewhere diversify more into global equities and away from country-specific equities, the focus will switch to those centers where there is most volume — the major trading centers and exchanges."

TOM SWAYNE, BUSINESS EXECUTIVE, JPMORGAN INVESTOR SERVICES
GLOBAL FINANCE, OCTOBER 2003

"Measurement alone achieves nothing. Measurement, however, leads to the identification of inefficiencies in the trading process, which, once addressed, can lead to improvements in the underlying process, thereby achieving greater efficiency and reducing costs."

MARK WESTWELL, VICE PRESIDENT, INFORMATION PRODUCTS EXECUTIVE, JPMORGAN INVESTOR SERVICES EMEA
FINANCIAL TIMES MANDATE, NOVEMBER 3, 2003

In a letter to the editors of *SIBOS Issues*, JPMorgan Investor Services' Ramy Bourgi says he is proud that the global custody industry was able to put aside its competitive instincts to debate important issues, as they did in the virtual roundtable discussion he participated in for an issue of *SIBOS Issues* earlier this year. "It was very interesting for me to have been part of this unique opportunity to hear the voice of the SWIFT community. This ongoing dialogue with friends and competitors will lead to a better understanding of the challenges we all face and how to deal with them more effectively."

RAMY BOURGI, SENIOR VICE PRESIDENT, BUSINESS EXECUTIVE, JPMORGAN INVESTOR SERVICES EMEA
SIBOS ISSUES, OCTOBER 2003

"An increasing number of investment managers are turning to global providers like JPMorgan for outsourcing solutions that can help them increase their competitive advantage. JPMorgan Message Express allows them to reduce operating costs, manage risks, and avoid large, multi-year investments in service delivery platforms. By freeing up staff and investment dollars for tasks more critical to their key objectives, managers are able to focus more on generating high quality revenues."

PAULA SAUSVILLE-ARTHUS, SENIOR VICE PRESIDENT, ASSET MANAGER SOLUTIONS GROUP EXECUTIVE, JPMORGAN INVESTOR SERVICES
IFI MAGAZINE, NOVEMBER 10, 2003

@thought

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J.P. Morgan Chase & Co. is a leading global financial services firm with assets of $793 billion* and operations in more than 50 countries. The firm is a leader in investment banking, financial services for consumers and businesses, financial transaction processing, investment management, private banking and private equity. A component of the Dow Jones Industrial Average, JPMorgan Chase is headquartered in New York and serves more than 30 million consumer customers nationwide, and many of the world's most prominent corporate, institutional and government clients. Information about JPMorgan Chase is available on the internet at www.jpmorganchase.com.

*October 2003

editor's clip

We hope you've enjoyed this issue of *Thought*. Your feedback is important to us. To contact us with questions, comments or to share story ideas, e-mail us at: Thought.Magazine@jpmorgan.com

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